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Investment Committee Perspective

Fourth Quarter 2021

Our Investment Committee meets no less than quarterly to evaluate asset class performance, analyze macroeconomic data and trends, and review asset class valuations and risks to refine our market outlook and tactical portfolio positioning. This quarterly letter summarizes the topics discussed during those investment committee meetings and provides guidance on our outlook and corresponding tactical investment strategy.

2021: A Year in Review

Reflecting on the performance of the markets during 2021, it's not hard to see the ebbs and flows as a reflection of the economic and emotional recovery we've collectively experienced as the pandemic continues to weigh heavily on all aspects of our lives. As we approach the two-year anniversary of the emergence of the coronavirus, a growing optimism is regularly met head on by the realities of a recovery stunted by COVID's stubbornness and the hangover effects of the fiscal and monetary stimulus that kept a more significant economic downturn at bay.

The fiscal and monetary stimulus measures we've discussed at length over the past couple of years were unprecedented in nature and scope. While some actions resulted in a near-spontaneous stimulative effect (direct stimulus payments or credits to taxpayers), others are more long-term (federal reserve quantitative easing). As with every action, there is an opposite and equal reaction; and the markets spent the second half of the year beginning to worry increasingly about those impacts.

You cannot engage in $20+ trillion stimulus measures worldwide without driving considerable inflation. The inflationary pressures are attributed to a surge in consumer demand, aided by fiscal stimulus, and further compounded by supply-chain disruptions and labor shortages. 2021 and 2022 will undoubtedly be remembered for inflation rates not seen since the late 1970s and ultimately for how policymakers attempt to moderate its effect. As such, we find it timely this quarter to focus on the U.S. Federal Reserve's impact on interest rates and financial markets and touch on the uncertain roadmap they now face for unwinding the mountains of liquidity provided over the past thirteen years since the 2008 Financial Crises.

Our investment committee focuses on monitoring intermediate and long-term secular trends that we believe can have a meaningful impact on our economic outlook and potential impact to financial markets. Specifically, there are a few core secular themes we've covered in our quarterly letters this past year that are as relevant today, if not more so, than when we wrote on them: *interest rates* (see our First Quarter 2021 letter), *U.S. growth stock valuations* (see our Second Quarter 2021 letter), *inflation* (see our Third Quarter 2021 letter), and the *U.S. Federal Reserve* (detailed in this Fourth Quarter 2021 letter).

The Great Unwinding

At the time of this writing, twenty-one months have passed since COVID-19 arrived on the shores of the United States. Since then, the virus has caused tremendous human and economic hardships. The COVID-19 pandemic and the mitigation efforts put in place to contain it delivered the most severe blow to the U.S. economy since the Great Depression. U.S. real gross domestic product (GDP) decreased at an annualized rate of 32.9 percent in the second quarter of 2020. More than 22 million jobs were lost in the first two months of the crisis and the U.S. unemployment rate rose from a 50-year low of 3.5 percent in February of 2020 to a postwar peak of 14.8 percent in April of 2020. The resulting disruptions to economic activity substantially tightened financial conditions and impaired the flow of credit to U.S. households and businesses.

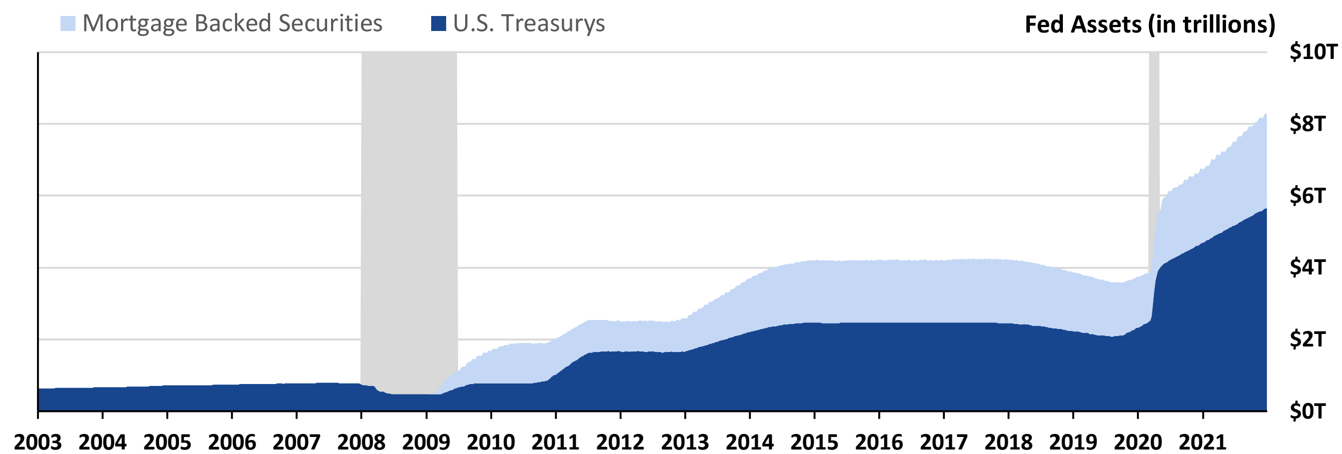
To mitigate the devastating economic impact, a global fiscal and monetary policy response was unleashed that was unprecedented in scale, scope, and speed. The robust actions of the Federal Reserve and Congress provided critical support to the economy in 2020 and have continued to contribute to what has turned out to be a robust economic recovery in 2021. Legislation passed by Congress provided a total of nearly $6 trillion in fiscal support to the U.S. economy - approximately 28 percent of U.S. GDP. The Federal Reserve acted equally decisively and deployed all the tools in its conventional toolkit along with some new ones to support the flow of credit to households and businesses. Chief among these Federal Reserve emergency actions was cutting interest rates to zero and initially launching a $700 billion round of quantitative easing that has since expanded to $4.6 trillion through December 2021.

What is "Quantitative Easing"? How the Federal Reserve uses its Balance Sheet to Manage the Economy

The term Quantitative Easing ("QE") is thrown around often without much explanation. In its simplest form, QE is an injection of liquidity into the banking system by way of the Federal Reserve serving as the *buyer of last resort* for government and mortgage securities. As a result, most Fed assets are made up of government and mortgage-backed bonds. Just like all market participants who purchase bonds, the Federal Reserve does so on the open market. When the Federal Reserve buys bonds, it creates banking reserves by crediting reserve balances to the bank it is transacting with via a digital banking ledger. Thus, more liquidity becomes available in the banking system driving interest rates lower, which causes individuals and businesses to increase borrowing and spending, boosting the economy in the process. This process is often misconstrued with the notion that the Fed is *printing* physical dollars to purchase assets, a process which is controlled by the Treasury and the US Bureau of Engraving and Printing. In actuality, the Fed injects liquidity by creating additional banking reserves.

The Federal Reserve's first meaningful quantitative easing occurred during the Great Recession in 2008. Prior to 2008, the Federal Reserve had approximately $870 billion on its balance sheet. By 2014, that amount had increased to $4.5 trillion. Adjusting its balance sheet was a relatively new process for the Fed at that time. The new policy of buying bonds on the secondary market was not widely used before the 2008 Great Recession but was quickly adopted by most of the central banks around the world to counter the effects of the 2008 global financial crisis and now again during the 2020 COVID-19 pandemic. As shown below in Exhibit 1, as of December 2021, the Fed has amassed more than $8 trillion of assets on its balance sheet, a direct result of the measures taken to combat the 2008 Global Financial Crisis and the 2020 COVID-19 pandemic.

EXHIBIT 1: Assets Held by the U.S. Federal Reserve



Note: Data as of December 31, 2021
Source: Board of Governors of the Federal Reserve System (US), H.4.1 Factors Affecting Reserve Balances

What is "Tapering"? How the Federal Reserve Reduces/Unwinds its Balance Sheet

Inflation has soared as evidenced by the December consumer price index increase of 7.0% from a year ago. This has increased market expectations that central banks will tighten money supply to lower prices and prevent economies from overheating. Prior to November, the Federal Reserve had insisted that inflation is "transitory" (i.e., not permanent) as a consequence of consumer prices recovering from drops at the height of the pandemic in 2020 known as the "base effect". In general, policymakers want to avoid harming the economic recovery by not withdrawing too much support too quickly, However, with inflation roaring, the Fed announced in November 2021 that it will begin to pull back its support of the economy ("tapering"), with the first step being a reduction in the rate of asset purchases it has been making via quantitative easing.

Until November, the Fed had been buying $120 billion in treasury and mortgage bonds per month which was reduced by $30 billion per month starting in December with a view to completely discontinue quantitative easing by March of 2022. This would set them up to then start raising interest rates, the more traditional tool they use to cool the economy and combat inflation. These moves signal optimism as to the state of the economy along with concern to the threat of inflation, at its highest level since the 1970s.

Once quantitative easing ends, the next move will be for the Fed to (1) start raising interest rates from the near-zero levels seen since April of 2020, with the first increase now expected in March and (2) continue to hike interest rates four to six more times throughout 2023. These future rate increases will only take place if their plan does not cause a significant economic impact, an increasingly difficulty assumption to make as the markets have become accustomed to their support. In addition to the discontinuation of quantitative easing (i.e., not buying more), the government securities that are owned by the Federal Reserve eventually dissolve as they mature over time. In the same way the Fed injects liquidity when it buys securities, it also removes liquidity by letting those securities mature and electing to not replace them with new assets. As the Fed stops purchasing securities, its balance sheet automatically shrinks as the bonds mature over time. This process is called "unwinding" and it has the opposite effect of quantitative easing as it removes liquidity.

In a normal economic expansion, increased spending leads to increased demand for goods and services. Businesses grow to meet demand. They hire more workers, and as workers become harder to find, businesses raise wages to attract talent. That comes at a cost to the businesses, so they then charge more for their products, which increases inflation. If this cycle goes too quickly, inflation can skyrocket.

Even though the Federal Reserve wants to keep the economy from overheating, it does not want to reduce its balance sheet too quickly either. In 2017, St. Louis Fed economist David Wheelock likened it to a car stopping at a stop sign. You want to gradually step on the brake rather than driving at full speed and then slamming on the brakes at the last minute. The risk is if inflation proves to be stickier and the Fed feels they are behind the curve on bringing inflation back down, they may be forced to hit the brakes too hard, reducing the amount of money available and potentially sending the economy into a recession.

While the effects of running down the Fed's balance sheet are unknown, it's sensible to predict that its impact will be smaller than quantitative easing, given how slowly the Fed plans to shrink its holdings. The Fed also plans to use the Fed funds rate to counteract any adverse effects. There are likely to be longer-term profound impacts to the economy and financial markets as we transition from a pedal-to-the-metal accommodative to a gradual tap-tap braking restrictive monetary policy. The end of ultra-low interest rates, very cheap leverage, and low volatility is upon us and will usher in higher interest rates effectively making it more costly to employ leverage. Unwinding this cheap leverage will add volatility to the financial markets.

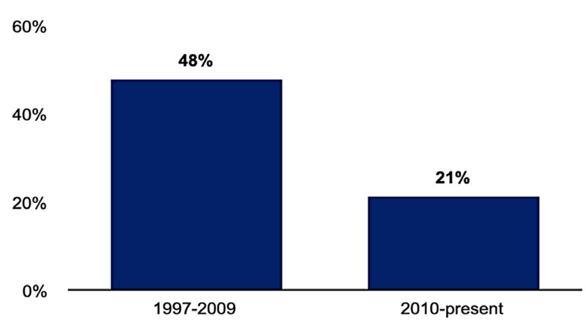
Implications for Financial Markets

"Peak everything" (i.e., food, used cars, commodities, real estate, stock markets) has undeniably been heavily influenced by the trillions of dollars in fiscal and monetary stimulus deployed over that past decade plus. All that excess liquidity/money had to go somewhere – and it did – it went everywhere. As Milton Friedman, Nobel prize winning economist, said in 1970: "Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output." Little has changed since then. The question is what happens to many of these assets - financial markets in particular - as the Fed now starts to unwind some of this excess liquidity.

A recent study by Bank of America's Equity & Quantitative Strategy groups highlights how corporate earnings and quantitative easing has influenced the U.S. stock market over time and demonstrates why the unwinding of the Fed's balance sheet might be problematic for U.S. stocks. They estimate that corporate earnings used to explain almost half of equity market returns up to the 2008 financial crisis, but since then earnings explain only 21%. Meanwhile, the expansion of the Fed's balance sheet ("QE") has explained 52% of stock market returns since 2010 when the Fed first started meaningful quantitative easing.

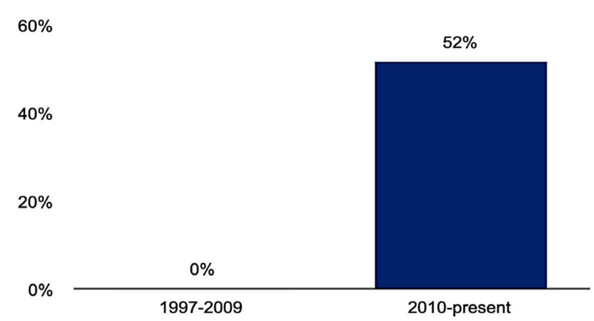
EXHIBIT 2: Corporate Earnings and Fed Balance Sheet Relationship with Stock Market Returns, pre- and post GFC

Prior to the 2008 Global Financial Crises, corporate earnings explained 48% of stock market returns and explain only 21% since



Source: FactSet, BofA US Equity & Quant Strategy

Since the 2010, 52% of *non-earnings* driven market cap changes has come from the Fed balance sheet expansion



Source: FactSet, BofA US Equity & Quant Strategy

The unwinding of the Fed's balance sheet is bound to have far-reaching consequences. Quantitative easing's injection of cheap money into the global financial system has had multiple knock-on effects that have contributed to record debt issuance and what feels like a never-ending bull market in real estate and stocks. As central banks around the world attempt to shrink their balance sheets, there is great uncertainty as to what effects that will have to the global economy and what impact it will have on global financial markets. The only thing that seems certain is that interest rates and market volatility will rise.

While rising interest rates presents challenges for all financial assets, given that higher interest rates lower the "present value" of the cash flows that these assets produce, we expect the greatest impact will be seen in long-duration assets, like growth stocks and long-term treasury bonds, which derive most of their value from cash flows expected to occur in the distant future. We maintain a maximum underweight to growth stocks and long-term treasury bonds to buffer the anticipated price declines these assets will experience as interest rates move higher.

A hopeful outcome in 2022 will be that inflation subsides as global supply chain issues improve, pent-up consumer demand dissipates, and the Federal Reserve gradually raises interest rates. That is our base case expectation. However, if inflation stays elevated for longer than anticipated, the Federal Reserve is likely to raise interest rates faster than the market anticipates which will create greater market volatility and possibly be a precursor to our next economic recession.

Conclusion

While markets face numerous risks as we start a new year, as they always do, there are still multiple, powerful positive tailwinds. Corporate earnings are incredibly strong and the performance of corporate America through the pandemic has been nothing short of amazing. Interest rates, while they will rise in 2022, remain exceptionally low and not close to levels that would historically be considered a headwind on economic activity. Personal savings remain high, unemployment remains low, and broadly speaking the U.S. economy is in strong shape. So, while there are risks to the markets and the economy that could result in more market volatility in 2022, on balance the near-term outlook remains decidedly positive.

As we reflect on 2021, and look forward to 2022, one of the biggest takeaways from another unpredictable year in the markets is that a well-planned, long-term-focused, diversified financial plan can withstand virtually any market surprise and related bout of volatility, including multiple COVID waves, inflation reaching 30-year highs, and the Federal Reserve removing historic accommodation. History proves markets are consistently unpredictable. Adding to that uncertainty is the unprecedented circumstances, challenges, and structural changes the global economy is currently facing. Investing in the face of uncertainty requires discipline, patience, and a willingness to stand away from the herd at times. It can feel uncomfortable to stay the course, keep or put more capital at risk when markets are plunging or refrain from chasing overvalued markets when they are soaring. We are confident a disciplined, long-term focus is the most effective strategy to achieve our clients' goals.

We understand the risks facing both the markets and the economy and we are committed to helping you navigate this still-challenging investment environment. Successful investing is a marathon, not a sprint, and even intense volatility is unlikely to alter a diversified approach to meet your long-term investment goals. It's critical that you stay invested, remain patient, and stick to the plan; as we've worked with you to establish a unique, robust investment plan based on your personal financial position, risk tolerance, and investment timeline.

The strong performance of markets in 2021 notwithstanding, we remain vigilant towards the risks to our clients' portfolios and the economy, and we thank you for your ongoing confidence and trust. Rest assured our entire team is dedicated to helping you successfully navigate this market environment. We believe our current tactical positioning in client portfolios, as illustrated in Exhibit 4 below, will allow for continued, albeit lower, growth while at the same time protecting portfolios for a rising interest rate and higher inflationary environment.

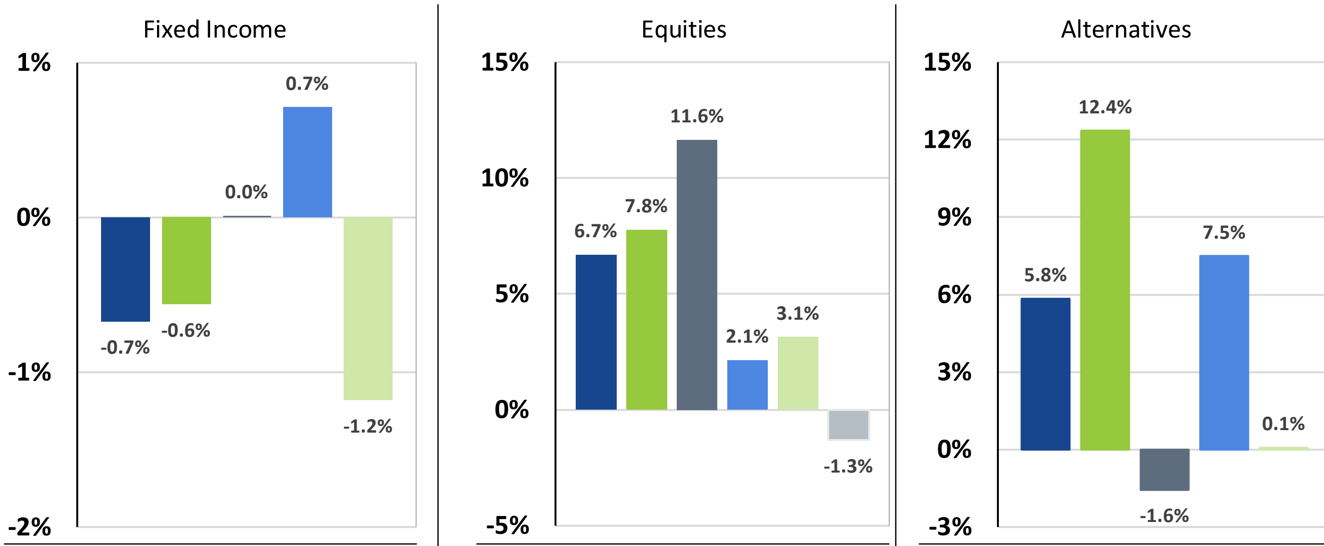
As always, we believe it is important to meet with our clients regularly to address any questions about portfolio performance and longer-term investment and financial planning objectives.

Please do not hesitate to contact us with any questions, comments, or to schedule a review meeting.

Cordially,

Causey Demgen & Moore Investment Committee
- Robb Stone, Nathanael Koch, Stephen Warren, Paul Demgen and John Connell

EXHIBIT 3: Fourth Quarter Asset Class Performance – Total Returns



Global Bonds	-0.7%
Short Term	-0.6%
Intermediate Term	0.0%
High Yield	0.7%
Foreign	-1.2%

Global Equities	6.7%
U.S. Value	7.8%
U.S. Growth	11.6%
U.S. Small	2.1%
Developed Int'l	3.1%
Emerging Markets	-1.3%

Alternative Blend	5.8%
Real Estate	12.4%
Nat Resources	-1.6%
Infrastructure	7.5%
Low Correlation	0.1%

Fixed Income

From the seemingly contradicting forces of the impact of the Omicron variant and inflation caused by supply chain disruptions, Treasury yields struggled to breakout in either direction, with the 10-year treasury yield settling at 1.5% on 12/31, the same yield seen at the end of the third quarter. However, despite the lack of movement at the longer end of the yield curve, the front end of the curve saw a meaningful jump in rates as the market priced in the increasing likelihood of multiple Fed rate hikes in 2022. As a result, short term bonds declined -0.6% and Intermediate-term bonds were a flat +0.0%. High yields bonds delivered strong performance of +0.7% as it captured the tailwinds of the "risk on" environment seen in the fourth quarter. Foreign bonds continue to struggle and fell -1.2% as the U.S. dollar strengthened (thus lowering the value of the currency component of non-U.S. dollar denominated bonds).

Equities

Global equity markets surged +6.7% in the fourth quarter as (1) the congressional gridlock in Washington has, at least temporarily, pushed out any significant tax law legislation changes, (2) the Federal Reserve appears to have woken up to the risk of higher inflation, (3) China real estate concerns stabilized, and (4) the outlook on the COVID Omicron variant slightly improved. U.S. equities outperformed their foreign counterparts, with U.S. Value gaining +7.8%, U.S. Growth surging +11.6% and U.S. Small caps lagging but still positive at +2.1%. Internationally, developed markets returned +3.1% while Emerging Markets found difficulty in overcoming the volatility presented by China's real estate concerns, falling -1.3% over the quarter.

Alternatives

With the consumer price index jumping +2.2% in the fourth quarter alone, alternative assets again proved their worth as portfolio diversifiers. Real Estate gained +12.4% in the quarter, Natural Resources fell -1.6%, Infrastructure climbed +7.5%, and Low Correlation assets delivered +0.1%.

EXHIBIT 4: Causey Tactical Asset Allocation Outlook

Please find below our Tactical Asset Allocation outlook as of December 31, 2021. The Investment Committee made no changes from its June 30, 2021 tactical asset allocation positioning during our most recent January 2022 meeting.

The Prior Outlook green triangles represents our portfolio positioning as of March 31, 2021.

Looking out over a three-to-five-year tactical horizon, the major risks we see are elevated U.S. stock valuations, in particular U.S. growth stocks, rising interest rates, and increasing inflation.

	Underweight					Overweight			
	- - - -	- - -	- -	-	Strategic	+	+ +	+ + +	+ + + +
OVERALL POSITION									
Cash	●								
Fixed Income	●								
Equities						●			
Alternatives						◆	●		
FIXED INCOME									
Short Bond	●		◆						
Intermediate Bond	●								
High Yield Bond						●			
Foreign Bond				●					
EQUITIES									
US Value					◆	●			
US Growth	●		◆						
US Small Cap									●
Developed Int'l						●			
Emerging Markets							●		
ALTERNATIVES									
Real Estate				●					
Natural Resources									●
Infrastructure									●
Low Correlation							◆		●

Current Outlook	●
Prior Outlook	◆

Underweight:

- **Short- and Intermediate-term Fixed Income** due to our outlook and concern for rising interest rates.
- **U.S. Growth stocks** due to their very high valuations (i.e. expensive).

Overweight:

- ***Floating* Rate bonds (within High Yield)** as their interest rates/coupons reset monthly or quarterly and therefore are less negatively impacted by rising interest rates.
- **U.S. Small-caps** as they offer very compelling valuations (i.e., cheap – particularly small cap value) relative to U.S. growth stocks.
- **Emerging Markets** as they look incredibly cheap relative to U.S. stocks broadly.
- **Natural Resources** and **Infrastructure** as *inflation-hedges* to mitigate the impact of rising/persistent inflation.
- **Low Correlation strategies** to offset underweight in fixed income as their *absolute-return* mandates should do well regardless of how Fixed Income (rising interest rates) or Equities (expensive valuations) perform.